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Legislative Audit Division

State of Montana

Report to the Legislature

December 1998

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 1998

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State Auditor's Office

This report contains six recommendations to the office related to:

- **Insurance and security settlements.**
- **Insurance security deposits not recorded on the state's accounting records.**
- **Abatement of training travel expenses.**
- **Recording financial information on the state's accounting records in the proper classifications.**

Direct comments/inquiries to:
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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1999, will be issued by March 31, 2000. Copies of the Single Audit Report, when available, can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 135, State Capitol
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Helena MT 59620-1705

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John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

December 1998

To the Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the State Auditor's Office for the two fiscal years ended June 30, 1998. Included in this report are recommendations concerning insurance and securities settlements, insurance security deposits, abatement of training travel expenses, depositing security examination fees, incorrect use of revenue and expenditure categories, inadequate segregation of duties, and the office's revenue receipt system not reconciling with the state's accounting system. The office's written response to the audit recommendations is included in the back of the audit report.

We thank the State Auditor and his staff for their assistance and cooperation.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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Legislative Audit Division

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 1998

State Auditor's Office

Members of the audit staff involved in this audit were Jody Brandt, Susan S. McEachern, and Lorry Parriman.

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State Auditor's Office

Mark O'Keefe, State Auditor

Dave Hunter, Deputy State Auditor
and Deputy Securities Commissioner

Frank Cote, Deputy Insurance Commissioner

John Huth, Central Services Administrator

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State Auditor's Office

This report contains the results of our financial-compliance audit of the State Auditor's Office for the two fiscal years ended June 30, 1998. We issued a qualified opinion on the financial schedules presented in this report due to improper recording of transfers to the General Fund and not recording insurance deposits held in trust for insurance companies. This means the reader should use caution when using the presented financial information and the supporting detailed information on the Statewide Budgeting and Accounting System (SBAS).

The report contains six recommendations directed to the office. The recommendations relate to not classifying insurance and securities settlements income properly and not recording all income related to these settlements on the state's accounting records; not recording insurance deposits held in custodial capacity on the state's accounting records; abating training travel expenditures rather than recording the third party reimbursement as revenue; depositing security examination fees; incorrect use of revenue and expenditure categories; inadequate segregation of duties; and the internal computer system not reconciling with SBAS. The office's written response to the audit begins on page B-3.

The listing below serves as a means of summarizing the recommendations contained in the report, the office's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the office:

A. Properly classify settlements in accordance with state policy.

Office Response: Concur. See page B-3.

B. Record all settlement revenue and expenditures not specific to a wronged party on the state's accounting records. . . . . Page 6

Office Response: Do Not Concur. See page B-4.

Report Summary

Recommendation #2

We recommend the office ensure all securities on deposit are assigned to the office and security deposits are recorded on the state's accounting records in accordance with law. . . . . Page 7

Office Response: Do Not Concur. See page B-5.

Recommendation #3

We recommend the office:

A. Record revenue and expenditures related to employee training travel on the state's accounting records in accordance with state policy.

Office Response: Concur. See page B-5.

B. Establish receivables for travel costs initially paid by the office and later reimbursed by a third party. . . . . Page 9

Office Response: Concur. See page B-5.

Recommendation #4

We recommend the office:

A. Seek legislation to allow deposit of securities examination revenue in the State Special Revenue Fund, or

Office Response: Concur. See page B-6.

B. Request General Fund budget authority to spend securities examination revenue. . . . . Page 9

Office Response: Concur. See page B-6.

Recommendation #5

We recommend the office record financial information on the state's accounting records in accordance with state policy. . . . . Page 11

Office Response: Concur. See page B-6.

Recommendation #6

We recommend the office:

A. Adequately segregate revenue collection, receipt, and recording duties.

Office Response: Concur. See page B-6.

B. Ensure revenue recorded on the state's accounting records is allocated to proper revenue classifications. . . . . Page 12

Office Response: Concur. See page B-6.

Introduction

General

We performed a financial-compliance audit of the State Auditor's Office (office) for fiscal years 1996-97 and 1997-98. The objectives of our audit were to:

1. Determine if the office complied with applicable laws and regulations.
2. Make recommendations for improvement in management and internal controls and financial operations.
3. Determine if the office's financial schedules present fairly the results of operations for the two fiscal years ended June 30, 1998.
4. Determine the implementation status of prior audit recommendations.

This report contains six recommendations to the office. Other areas of concern deemed not to have a significant impact on the successful operations of the programs within the State Auditor's Office are not specifically included in the report, but have been discussed with management.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations.

Office Background and Organization

The State Auditor's Office (office) was established by Article VI, section 1 of the Montana Constitution. The State Auditor is both the ex-officio Commissioner of Insurance and the ex-officio Commissioner of Securities. The State Auditor licenses and regulates insurance companies and agents within the state, and regulates and registers securities dealers. The State Auditor also serves as a member of the State Land Board and the Crop Hail Insurance Board. Total full-time equivalents (FTE) of the office are 64. The office currently has 11 exempt positions.

The office is organized as follows:

1. The Central Management Division is responsible for the administrative, budgeting, personnel, and accounting functions of the office. The division also provides the State Auditor support as he

fulfills his duties on the State Land Board and the Crop Hail Insurance Board. (9 FTE)

2. The Insurance Division regulates the insurance industry in Montana. Its duties include resolving insurance consumer inquiries and complaints involving agents, coverage, and companies; licensing and reviewing the market and financial condition of insurance companies; collecting the insurance premium tax; reviewing rates and reviewing and approving forms used by insurance companies; licensing, testing, and administering a continuing education program for all agents seeking to conduct insurance business in the state; and investigating insurance code and rule violations. (43 FTE)

3. The Securities Division is responsible for the administration and enforcement of the Securities Act of Montana. The division is responsible for the registration of securities issuers, salespeople, investment advisers, broker-dealers, and investment adviser representatives. Additionally, it investigates instances of unregistered or fraudulent securities transactions. (12 FTE)

The office is responsible for distributing a portion of insurance premium taxes to the Montana Public Employees' Retirement Division and to fire and police departments in qualifying Montana cities and towns. The office also distributes federal forest reserve moneys to Montana counties.

Prior Audit Recommendations

Prior Audit Recommendations

We performed the prior financial-compliance audit of the office for the two fiscal years ended June 30, 1996. The report contained three recommendations to the office. During the current audit, we determined the office implemented all three of the recommendations.

Insurance and Securities Settlements

Sections 30-10-305 and 33-1-318, MCA, allow the State Auditor, as Insurance and Security Commissioner, to fine companies or individuals for violation of insurance or securities laws. Section 2-4-603, MCA, states "Unless precluded by law, informal disposition may be made of any contested case by stipulation, agreed settlement, consent order, or default."

During the audit period, we noted the office entered into three consent agreements, totaling $370,000, with companies that the office believed had violated insurance or securities laws. The consent agreements do not constitute admission by the company of any wrong doing. According to office management, companies want to settle the issue with the office to avoid court costs and a "fine" showing on the company's record. Because there is no finding of wrong doing by the company, sections 30-10-305 and 33-1-318, MCA, which require fines for insurance and securities violations be deposited in the general fund, do not apply. The office and company negotiate the amount of the settlement and the use of those funds. For the three consent agreements we reviewed, the funds were used for community service purposes.

The office recorded the revenue from these settlements as Licenses and Permits on the state's accounting records. This revenue does not meet the definition of Licenses and Permits established in state policy. According to state policy, the revenue would be more properly classified as Settlements.

Additionally, one of the consent agreements noted above required the company to pay $10,000 to a national securities trust to be used in Montana for investor protection education. Two additional consent agreements, totaling $23,500, were entered into by the office subsequent to our audit period. This settlement income was used for similar purposes as the settlements noted above, such as for community benefits and public service announcements. The $33,500 in settlement income from these three consent agreements was not recorded on the state's accounting records. In all three instances, the company or individuals made payment directly to the trust or private businesses. According to office management, these companies may not have been as willing to

settle the issue, if they were required to pay the funds to the office. The office stated the company or individual wants the tax deduction as a contribution and the positive publicity involved in handing the check to the private business.

The office is involved in the negotiations of the settlements and is named in the settlement and consent agreements. Also, the settlements are not specific to a wronged party and are benefiting the securities and insurance industry and Montanans, and are consistent with the regulatory purpose of the office. Therefore, the office should record these settlements as revenue and expenditures in its accounting records.

Recommendation #1

We recommend the office:

A. Properly classify settlements in accordance with state policy.

B. Record all settlement revenue and expenditures not specific to a wronged party on the state's accounting records.

Insurance Security Deposits

Section 33-2-111, MCA, states in order for an insurer to sell insurance in the state of Montana it must maintain in trust through the Commissioner of Insurance a deposit of cash or authorized securities as outlined in state law. Section 33-2-606, MCA, requires all securities not negotiable by delivery be assigned to the commissioner. The assignment of securities agreement assigns and transfers the securities on deposit to the commissioner in trust for all policy holders and creditors of the company. The assignment is a complete transfer of the securities to the commissioner as a deposit to be held in trust. The securities are issued in the name of the insurer that provided the security for deposit. The insurer's rights are assigned to the state of Montana through an assignment of security agreement between the office, insurer, and trust. In order to remove or exchange any security on deposit, the insurer must receive authorization from the office and the trust. The office does not record the security deposits on the state's accounting records.

"Property held in trust" identifies the value assigned to property held by the state in a trustee, custodial or fiduciary capacity. Section 17-1-102, MCA, requires all state agencies to record all financial transactions on the state's accounting records in accordance with generally accepted accounting principles. According to office management, the market value of the deposits assigned to the office at June 30, 1998 is approximately $12.8 million. Because the office does not record the security deposits as "property held in trust" on the state's accounting records, assets and liabilities are understated by $12.8 million at June 30, 1998. This resulted in a qualification of the Independent Auditor's Report beginning on page A-3.

Office management stated these deposits are not the property of the state of Montana and should not be recorded on the state's accounting records. Because these securities are held by the commissioner in a fiduciary capacity and are assigned to the office, they should be recorded as "property held in trust" on the state's accounting records.

In addition, we reviewed five insurer deposits for proper assignment and noted one was not assigned to the office in accordance with state law. Office personnel stated the insurer had replaced the existing security with a new security and the office overlooked having the insurer complete a new assignment agreement. The office should review its procedures regarding assignment of securities and ensure all securities are assigned to the office in accordance with state law.

Recommendation #2

We recommend the office ensure all securities on deposit are assigned to the office and security deposits are recorded on the state's accounting records in accordance with law.

Findings and Recommendations

Proper Recording of Financial Transactions on the State's Accounting Records

Section 17-1-102, MCA, requires all state agencies to record all financial transactions on the state's accounting records in accordance with generally accepted accounting principles (GAAP). The Department of Administration, Accounting and Management Support Division, has adopted state accounting policies which comply with GAAP. Accounting for financial activity in accordance with these requirements improves the quality, consistency, and comparability of the resulting financial information among state agencies. It also ensures that revenue and expenditures are properly and consistently measured within each fiscal year. We noted the following instances where the office did not record financial activity in accordance with state policy.

Abatement of Training Travel Expenses

The North American Securities Administrators' Association (NASAA) and the National Association of Insurance Commissioners (NAIC) pay all or a portion of employee travel costs for attending NASAA and NAIC training courses. The office or the employee initially pays for the training costs and later receives reimbursement from the organization.

When the office receives reimbursement, it abates or reduces the expenditures initially recorded rather than recording revenue and expenditures for the training costs. State policy allows expenditure abatements for specific items which are nonrecurring and nonroutine in nature. Since office employees attend the training courses as part of their jobs, state policy requires these expenditures and the related revenue be recorded on the state's accounting records. As a result, revenue and expenditures are understated by $6,734 and $3,442, respectively, in fiscal years 1996-97 and 1997-98. We were unable to determine the amount of unrecorded revenue and expenditures related to some of the training, since employees were reimbursed directly for training costs.

The office began tracking the initial airline ticket purchases at fiscal year-end 1997-98, to ensure the office received reimbursement from its employees and noted one employee had not reimbursed the state for an airline ticket purchased approximately one year ago. The employee subsequently requested reimbursement from NASAA and reimbursed the state.

Recommendation #3

We recommend the office:

A. Record revenue and expenditures related to employee training travel on the state's accounting records in accordance with state policy.

B. Establish receivables for travel costs initially paid by the office and later reimbursed by a third party.

Security Examinations

State law requires the office to conduct examinations of securities companies conducting business in the state of Montana. During the previous audit, we noted the office abated the expenditures related to securities examinations. In fiscal year 1997-98, the office received State Special Revenue Fund budget authority of $10,000 through Chapter 551, Session Laws of 1997, to record the securities examination costs on the state's accounting records.

Section 30-10-115, MCA, requires the office deposit all moneys received for securities examinations in the General Fund. In fiscal year 1997-98, the office deposited securities examination revenue of $23,462 in the State Special Revenue Fund. Office management stated the security examination activity was recorded in the State Special Revenue Fund, since that is where they received budget authority. Under generally accepted accounting principles, costs should be recorded where the corresponding revenue is recorded. The office transferred the excess of approximately $14,000 in revenue received over securities examination costs to the General Fund in accordance with section 30-10-115, MCA.

Recommendation #4

We recommend the office:

A. Seek legislation to allow deposit of securities examination revenue in the State Special Revenue Fund, or

B. Request General Fund budget authority to spend securities examination revenue.

Findings and Recommendations

Incorrect Use of Revenue and Expenditure Categories

As stated previously, the Department of Administration, Accounting and Management Support Division, has established state policy for recording financial activity on the state's accounting system. This includes establishing and defining the various revenue and expenditure categories for agencies to use when recording financial activity. We noted the following instances where the office did not use the proper category as defined in state policy.

Residual Equity Transfers

Section 30-10-115, MCA, requires the office record security portfolio registration fees in the State Special Revenue Fund. These funds may be used to defray the expenses of the office in discharging its administrative and regulatory powers and duties in relation to portfolio registrations. Any excess security portfolio registration fees must be deposited in the General Fund.

In accordance with state law, the office transferred the excess security portfolio registration fees to the General Fund. These transfers are normally made on a monthly basis. The office recorded transfers to the General Fund from the State Special Revenue Fund using residual equity transfers rather than budgeted transfers. State policy defines residual equity transfers as identifying the amount of nonrecurring or nonroutine transfers of equity between accounting entities. It further defines budgeted transfers as identifying amounts transferred into or from one accounting entity to another accounting entity.

As a result, residual equity transfers are overstated by $2,313,726 and $1,816,225 in fiscal years 1996-97 and 1997-98, respectively, and budgeted transfers are understated by the same amounts on the state's accounting records. This resulted in a qualification of the Independent Auditor's Report beginning on page A-3.

Prior Year Revenue Adjustment

The office receives insurance premium taxes from insurance companies transacting business in the state of Montana. Insurance companies pay estimated premium taxes on a quarterly basis. This can result in overpayment of premium taxes by insurance companies. The office either refunds the overpayment to the insurance company or applies the excess premium tax to the next year's taxes for the insurance company.

At the end of each fiscal year, the office establishes a liability for the amount of overpayments by insurance companies.

In fiscal year 1996-97, the office properly reversed the liability transaction; however, the office used a prior year revenue adjustment category as part of the transaction. Due to the nature of the transaction, the office should have used current year revenue as the offset to the liability. As a result, prior year revenue adjustments are overstated by $853,232 and current year revenue is understated by the same amount in fiscal year 1996-97 in the General Fund. Office management stated the use of the wrong revenue category was human error.

Recommendation #5

We recommend the office record financial information on the state's accounting records in accordance with state policy.

Revenue Collection Procedures

The office uses a computerized revenue receipting system to classify securities, insurance, and other revenue received by type of revenue. Central services personnel enter each receipt in the receipting system and record total daily receipts as uncleared collections on the Statewide Budgeting and Accounting System (SBAS). Program personnel then access the receipting system and using the documentation submitted with the payment, classify each receipt according to type of revenue. A report is generated monthly that identifies total revenue by type. Central services personnel use this report to transfer uncleared collections into the appropriate revenue classification on SBAS. We noted the following issues related to the office's revenue collection procedures.

Segregation of Duties

One employee opens the mail, endorses the checks, stamps the check and documentation with receipt number, enters information on the receipting system, prepares the deposit slip and related SBAS document, and deposits the funds with the State Treasurer. State policy requires no one person perform incompatible functions. Incompatible functions place an employee in a position to perpetrate and conceal errors and irregularities in the normal course of their duties. Incompatible

functions have been defined by state policy as record keeping, authorization, operations, and custodianship.

During the previous audit of the office, we noted the revenue collection duties were adequately segregated. When we inquired why the office changed procedures, office management stated they reallocated job duties between two positions, since its employees were more experienced in their job duties. This shift in job duties resulted in inadequate segregation of duties.

Reconciliation of Internal System and SBAS

The office completes a monthly reconciliation of its internal computer system and SBAS. The classifications of revenue codes from the internal system are used to record the revenue on SBAS. We reviewed the reconciliation at June 30, 1998 and noted a net difference of $51,046. Office personnel could not explain this difference. Since the revenue is deposited in the State Treasury, total revenue on SBAS is accurate for the office; however, revenue may not be recorded in the proper revenue classification. Office management stated its internal system is not reliable in computing the allocation of revenue between classifications. Office management stated they are currently working on implementing a new computer system for recording the receipt of revenue and allocating revenue into the proper revenue classifications.

Recommendation #6

We recommend the office:

A. Adequately segregate revenue collection, receipt, and recording duties.

B. Ensure revenue recorded on the state's accounting records is allocated to proper revenue classifications.

Independent Auditor's Report & Office Financial Schedules

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the State Auditor's Office for each of the two fiscal years ended June 30, 1997 and June 30, 1998. The information contained in these financial schedules is the responsibility of the office's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than generally accepted accounting principles. The schedules are not intended to be a complete presentation and disclosure of the office's assets and liabilities.

The office recorded transfers to the General Fund from the Special Revenue Fund using Residual Equity Transfers rather than Budgeted Transfers-In and Budgeted Transfers-Out, in accordance with state policy. As a result, Cash Transfers are overstated by $2,313,726 and $1,816,225 in fiscal years 1996-97 and 1997-98, respectively, on the Schedules of Changes in Fund Balances and Budgeted Transfers-In and Budgeted Transfer-Out are understated by the same amounts on the Schedules of Total Revenues & Transfers-In and Schedules of Total Expenditures & Transfers-Out.

As of June 30, 1998, insurance deposits totaling $12,857,863, were not recorded on the state's accounting records as Property Held in Trust in the Agency Fund. Since these deposits are held in trust for the insurance

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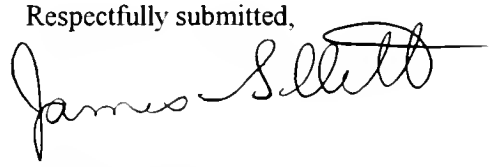
companies by the office for the company to operate in the state of Montana, state policy requires the deposits be recorded on the state's accounting records. As a result, Property Held in Trust is understated by $12,857,863 in the Agency Fund on the Schedule of Changes in Fund Balances for the fiscal year ended June 30, 1998. At June 30, 1997, Property Held in Trust is understated by a similar amount. Also, additions and reductions to Property Held in Trust are misstated by the amount of deposits received and disbursed during fiscal years 1996-97 and 1997-98. It was not practical for us to obtain the actual amount of additions and reductions for fiscal years 1996-97 and 1997-98 or the amount of Property Held in Trust at June 30, 1997, but we believe the amounts are material.

In our opinion, except for the effects of the matters discussed in paragraphs four and five, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the State Auditor's Office for the two fiscal years ended June 30, 1997 and 1998, in conformity with the basis of accounting described in note 1.

Respectfully submitted,



James Gillett, CPA
Deputy Legislative Auditor

September 29, 1998

STATE AUDITOR'S OFFICE
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 1998

	General Fund	Special Revenue Fund
FUND BALANCE: July 1, 1997	$ (181,875) [1]	$ (2,073,354)
ADDITIONS		
Budgeted Revenues & Transfers-In	40,971,275 [2]	11,538,423
Nonbudgeted Revenues & Transfers-In		310,000
Prior Year Revenues & Transfers-In Adjustments	(22,281)	(40)
Cash Transfers In (Out)	(16,881,182) [2,3]	(9,362,453) [2,3]
Direct Entries to Fund Balance	(9,983,121) [2]	9,983,121 [2]
Total Additions	14,084,691	12,469,051
REDUCTIONS		
Budgeted Expenditures & Transfers-Out	13,653,601 [2]	9,456,266
Nonbudgeted Expenditures & Transfers-Out		68,568
Prior Year Expenditures & Transfers-Out Adjustments	(13,048)	500
Total Reductions	13,640,553	9,525,334
FUND BALANCE: June 30, 1998	$ 262,263 [1]	870,363

[1] See note 2 on page A-12.
[2] See note 5 on page A-13.
[3] See note 6 on page A-13.

This schedule is prepared from the Statewide Budgeting and Accounting System.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 1997

	General Fund	Special Revenue Fund
FUND BALANCE: July 1, 1996	$ (1,060,019) [1]	$ 114,461
ADDITIONS		
Budgeted Revenues & Transfers-In	29,346,662	22,897,476 [2]
Nonbudgeted Revenues & Transfers-In		60,000
Prior Year Revenues & Transfers-In Adjustments	485,970	(145)
Cash Transfers In (Out)	(26,815,365) [3]	(2,313,726) [3]
Direct Entries to Fund Balance		89,694
Total Additions	3,017,267	20,733,299
REDUCTIONS		
Budgeted Expenditures & Transfers-Out	2,144,972	22,917,136 [2]
Nonbudgeted Expenditures & Transfers-Out		4,500
Prior Year Expenditures & Transfers-Out Adjustments	(5,849)	(522)
Total Reductions	2,139,123	22,921,114
FUND BALANCE: June 30, 1997	$ (181,875) [1]	$ (2,073,354)

[1] See note 2 on page A-12.
[2] See note 3 on page A-12.
[3] See note 6 on page A-13.

This schedule is prepared from the Statewide Budgeting and Accounting System.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 1998

	General Fund	Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Licenses and Permits	$ 7,131,467	$ 3,213,935	$ 10,345,402
Taxes	33,744,950		33,744,950
Investment Earnings		76,358	76,358
Fines and Forfeits	72,577		72,577
Federal		8,558,090	8,558,090
Total Revenues & Transfers-In	40,948,994	11,848,383	52,797,377
Less: Nonbudgeted Revenues & Transfers-In		310,000	310,000
Prior Year Revenues & Transfers-In Adjustments	(22,281)	(40)	(22,321)
Actual Budgeted Revenues & Transfers-In	40,971,275	11,538,423	52,509,698
Estimated Revenues & Transfers-In	46,752,934	12,177,508	58,930,442
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (5,781,659)	$ (639,085)	$ (6,420,744)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS			
Licenses and Permits	$ 703,731	$ 563,967	$ 1,267,698
Taxes	(6,502,967)		(6,502,967)
Investment Earnings		(11,142)	(11,142)
Fines and Forfeits	17,577		17,577
Federal		(1,191,910)	(1,191,910)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (5,781,659)	$ (639,085)	$ (6,420,744)

This schedule is prepared from the Statewide Budgeting and Accounting System.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 1997

	General Fund	Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Licenses and Permits	$ 6,547,951	$ 2,479,481	$ 9,027,432
Taxes	22,989,639	11,007,070	33,996,709
Investment Earnings		87,544	87,544
Fines and Forfeits	295,042		295,042
Federal		9,383,236	9,383,236
Total Revenues & Transfers-In	29,832,632	22,957,331	52,789,963
Less: Nonbudgeted Revenues & Transfers-In		60,000	60,000
Prior Year Revenues & Transfers-In Adjustments	485,970	(145)	485,825
Actual Budgeted Revenues & Transfers-In	29,346,662	22,897,476	52,244,138
Estimated Revenues & Transfers-In	29,707,510	28,108,328	57,815,838
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (360,848)	$ (5,210,852)	$ (5,571,700)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS			
Licenses and Permits	$ 1,076,922	$ 481,514	$ 1,558,436
Taxes	(1,677,812)	(8,146)	(1,685,958)
Investment Earnings		(62,456)	(62,456)
Fines and Forfeits	240,042	(5,000)	235,042
Federal		(5,616,764)	(5,616,764)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (360,848)	$ (5,210,852)	$ (5,571,700)

This schedule is prepared from the Statewide Budgeting and Accounting System.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 1998

PROGRAM EXPENDITURES & TRANSFERS-OUT BY OBJECT	Central Management	Insurance	Securities	Local Assistance Distributions	Federal Forest Reserve Funds	Total
Personal Services						
Salaries	$ 247,405	$ 1,246,057	$ 316,001			$ 1,809,463
Employee Benefits	61,441	313,595	81,760			456,796
Total	308,846	1,559,652	397,761			2,266,259
Operating Expenses						
Other Services	19,840	242,015	41,909			303,764
Supplies & Materials	37,244	147,306	25,161			209,711
Communications	7,558	97,351	16,460			121,369
Travel	1,925	44,165	9,502			55,592
Rent	11,155	44,016	11,953			67,124
Repair & Maintenance	1,524	4,120	1,490			7,134
Other Expenses	2,883	66,390	37,376			106,649
Total	82,129	645,363	143,851			871,343
Equipment & Intangible Assets						
Equipment		9,462				9,462
Total		9,462				9,462
Local Assistance						
From Federal Sources					$ 8,634,448	8,634,448
From Other Income Sources				$ 11,384,374		11,384,374
Total				11,384,374	8,634,448	20,018,822
Total Program Expenditures & Transfers-Out	$ 390,975	$ 2,214,477	$ 541,612	$ 11,384,374	$ 8,634,448	$ 23,165,886
PROGRAM EXPENDITURES & TRANSFERS-OUT BY FUND						
General Fund	$ 364,045	$ 1,502,439	$ 389,695	$ 11,384,374		$ 13,640,553
Special Revenue Fund	26,930	712,038	151,917		$ 8,634,448	9,525,333
Total Program Expenditures & Transfers-Out	390,975	2,214,477	541,612	11,384,374	8,634,448	23,165,886
Less: Nonbudgeted Expenditures & Transfers-Out		38,068	30,500			68,568
Prior Year Expenditures & Transfers-Out Adjustments	351	(11,378)	(1,522)			(12,549)
Actual Budgeted Expenditures & Transfers-Out	390,624	2,187,787	512,634	11,384,374	8,634,448	23,109,867
Budget Authority	406,345	2,266,688	524,621	11,754,817	9,837,500	24,789,971
Unspent Budget Authority	$ 15,721	$ 78,901	$ 11,987	$ 370,443	$ 1,203,052	$ 1,680,104
UNSPENT BUDGET AUTHORITY BY FUND						
General Fund	$ 15,721	$ 35,406	$ 4,079	$ 370,443		$ 425,649
Special Revenue Fund		43,495	7,908		$ 1,203,052	1,254,455
Unspent Budget Authority	$ 15,721	$ 78,901	$ 11,987	$ 370,443	$ 1,203,052	$ 1,680,104

This schedule is prepared from the Statewide Budgeting and Accounting System.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 1997

PROGRAM EXPENDITURES & TRANSFERS-OUT BY OBJECT	Central Management	Insurance	Securities	Local Assistance Distributions	Federal Forest Reserve Funds	Pension Adjustment Retired Firemen [1]	Total
Personal Services							
Salaries	$ 229,184	$ 1,161,785	$ 269,179				$ 1,660,148
Employee Benefits	55,446	290,537	68,974				414,957
Total	284,630	1,452,322	338,153				2,075,105
Operating Expenses							
Other Services	14,420	55,458	22,626				92,504
Supplies & Materials	10,788	46,437	13,278				70,503
Communications	8,660	81,431	17,070				107,161
Travel	721	15,028	1,729				17,478
Rent	10,051	40,920	11,189				62,160
Repair & Maintenance	2,895	9,261	2,722				14,878
Other Expenses	3,375	26,247	5,801				35,423
Total	50,910	274,782	74,415				400,107
Equipment & Intangible Assets							
Equipment	1,533	44,962	2,381				48,876
Total	1,533	44,962	2,381				48,876
Local Assistance							
From Federal Sources					$ 9,470,780		9,470,780
From Other Income Sources				$ 12,944,316		$ 8,648	12,952,964
Total				12,944,316	9,470,780	8,648	22,423,744
Debt Service							
Loans		103,405	9,000				112,405
Total		103,405	9,000				112,405
Total Program Expenditures & Transfers-Out	$ 337,073	$ 1,875,471	$ 423,949	$ 12,944,316	$ 9,470,780	$ 8,648	$ 25,060,237
PROGRAM EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	$ 325,288	$ 1,469,944	$ 343,891				$ 2,139,123
Special Revenue Fund	11,785	405,527	80,058	$ 12,944,316	$ 9,470,780	$ 8,648	22,921,114
Total Program Expenditures & Transfers-Out	337,073	1,875,471	423,949	12,944,316	9,470,780	8,648	25,060,237
Less Nonbudgeted Expenditures & Transfers-Out			4,500				4,500
Prior Year Expenditures & Transfers-Out Adjustments	(40)	(4,169)	(2,162)				(6,371)
Actual Budgeted Expenditures & Transfers-Out	337,113	1,879,640	421,611	12,944,316	9,470,780	8,648	25,062,108
Budget Authority	352,633	1,893,704	427,666	12,944,317	15,150,000	1,163,000	31,931,320
Unspent Budget Authority	$ 15,520	$ 14,064	$ 6,055	$ 1	$ 5,679,220	$ 1,154,352	$ 6,869,212
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	$ 2,296	$ 14,064	$ 6,055				$ 22,415
Special Revenue Fund	13,224			$ 1	$ 5,679,220	$ 1,154,352	6,846,797
Unspent Budget Authority	$ 15,520	$ 14,064	$ 6,055	$ 1	$ 5,679,220	$ 1,154,352	$ 6,869,212

[1] See note 4 on page A-13

This schedule is prepared from the Statewide Budgeting and Accounting System
Additional information is provided in the notes to the financial schedules beginning on page A-11

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 1998

1. Summary of Significant Accounting Policies

Basis of Accounting

The office uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental Funds. In applying the modified accrual basis, the office records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when the office incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the office to record the cost of employees' annual leave and sick leave when used or paid.

Expenditures and expenses may include: entire budgeted service contracts even though the office receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the Statewide Budgeting and Accounting System (SBAS) without adjustment, except for the reclassification of agency fund activity in fiscal year 1996-97. Consequently, these schedules do not agree in all cases to final SBAS summary reports. The reclassification is explained in note 3.

Accounts are organized in funds according to state law. The office uses the following funds:

Governmental Funds

General Fund - to account for all financial resources except those required to be accounted for in another fund. Beginning in fiscal year 1997-98 the Firemen's and Municipal Police Officers' Pension Tax and Insurance Premiums are recorded in this fund.

Special Revenue Fund - to account for proceeds of specific revenue sources legally restricted to expenditures for specific purposes. The office's Special Revenue Fund includes Insurance and Security Division activity such as the Securities and Insurance Examination Fees, Insurance Industry Continuing Education Program, and Securities Portfolio Registration Program. Also recorded in the office's Special Revenue Fund is the receipt and disbursement of Federal Forest Reserve Funds to Montana counties and private funds received from securities and insurance settlements.

2. General Fund Balances

The negative fund balance in the General Fund does not indicate overspent appropriation authority. The General Fund is a statewide fund. Each agency does not have a separate General Fund since its only authority is to pay obligations from the statewide General Fund within its appropriation limits. Each agency receives cash or other assets from the statewide fund when it pays General Fund obligations. For the fiscal year ended June 30, 1998, the office's assets exceed outstanding liabilities, which resulted in a positive ending fund balance. For the fiscal year ended June 30, 1997, the office's outstanding liabilities exceed the assets the agency has placed in the fund, resulting in a negative ending fund balance.

3. Agency Fund Reclassification

The office receives Federal Forest Reserve Funds from the U.S. Department of Agriculture (CFDA 10.665). This revenue is derived from timber proceeds and use fees collected by the federal government for National Forest Land in Montana. The office distributes these funds and related interest earnings to Montana counties in accordance with section 17-3-212, MCA.

In fiscal year 1996-97, the office recorded the receipt and disbursement of $9,470,780 in an Agency Fund. In fiscal year 1997-98, this activity was appropriately accounted for in the Special Revenue Fund. In order

to properly reflect the receipt and subsequent disbursement of the federal forest reserve funds for fiscal year 1996-97, the activity has been reclassified on the office's financial schedules and reported in the Special Revenue Fund.

4. **Pension Adjustment for Retired Firemen Program**

During the 1997 Legislative Session, section 19-13-1006, MCA, was repealed. This section related to supplemental payment for persons retiring before July 1, 1973. As a result, the pension adjustment for Retired Firemen Program was eliminated in fiscal year 1997-98.

5. **Firemen and Police Retirement Activity**

Beginning in fiscal year 1997-98, the Firemen and Police Retirement activity moved from the Special Revenue Fund to the General Fund in accordance with changes in state law during the 1997 Legislative Session. The retirement benefits are based on a fiscal year, whereas related revenue is collected on a calendar year basis. The Cash Transfers and Direct Entries to Fund Balance amounts for fiscal year 1997-98 in the General Fund and Special Revenue Fund relate to the transferring of this activity. In addition, the increase in revenue and expenditure activity in the General Fund for fiscal year 1997-98 is a result of the transfer of this activity from the Special Revenue Fund to the General Fund.

6. **Cash Transfers Out**

In addition to the Firemen and Police Retirement activity discussed in note 5, the Cash Transfers Out amounts include approximately $29 million in fiscal year 1996-97 and $26 million in fiscal year 1997-98 of excess revenue collected by the office and deposited in the General Fund. The Cash Transfer amounts also include $2,313,726 and $1,816,225 in fiscal years 1996-97 and 1997-98, respectively, of Residual Equity Transfers which should have been recorded as Budgeted Transfers-In and Budgeted Transfers-Out.

Office Response

STATE AUDITOR
STATE OF MONTANA

Mark O'Keefe
STATE AUDITOR

COMMISSIONER OF INSURANCE
COMMISSIONER OF SECURITIES

December 4, 1998

DEC - 4 1998

Mr. Scott A. Seacat
Legislative Auditor
Office of the Legislative Auditor
State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Dear Mr. Seacat:

We have reviewed your financial compliance audit for the two fiscal years ending June 30, 1998. Our response to each audit recommendation follows:

Recommendation #1:

We recommend the office:

A. Properly classify settlements in accordance with state policy.

B. Record all settlement revenue and expenditures not specific to a wronged party on the state's accounting records.

Agency Response:

We concur with the Legislative Auditor's recommendation #1A that revenue from settlements, which this office previously recorded as "Licenses and Permits" on the state's accounting records, "would now be more properly classified as "Settlements." However, since the category of "Settlements" is a new one created by the Department of Administration ***after*** the events described in the Legislative Auditor's report, we disagree with the implication on page v of the report that this office was "not classifying insurance and securities settlement income properly . . . ." All settlements entered into by the State Auditor involving payments to or through the State of Montana have been recorded on the state's accounting system. The Department of Administration created a new settlements revenue category on November 5, 1998, and remaining settlement proceeds have now been transferred to that code.

Mitchell Building/PO Box 4009/Helena, Montana 59604-4009/(406) 444-2040/1-800-332-6148/FAX: (406) 444-3497

As noted by the Legislative Auditor, three settlements totaling $33,500, and involving direct payments from the settling party to entities outside of state government, were not recorded on the state accounting system. However, all settlement documents are public documents and are available in the State Auditor's Office.

We disagree with the Legislative Auditor's recommendation #1B that this office should record all so-called settlement revenue and expenditures "not specific to a wronged party" on the state's accounting records. The Legislative Auditor's staff base their recommendation upon the incorrect presumption that the Commissioner ***controls*** settlement terms and also, therefore, any financial transaction resulting from those settlement terms. The Legislative Auditor's staff made clear in discussions that their recommendation #1B:

(1) reaches ***all*** such resolutions of regulatory disputes, even those involving no legal proceedings whatsoever; and
(2) reaches ***all*** financial or other benefits of such regulatory resolutions, even when no revenue whatsoever comes to or through this office; and
(3) subjects ***all*** negotiations by the elected State Auditor in such cases to separate approval or veto by the Governor's budget director as non-budgeted expenditures.

We believe that such an expansive recommendation will needlessly and seriously impede regulation by ***any*** state agency negotiating a resolution to benefit Montana consumers in general: whenever, for instance, an insurance or mining or utility company agrees to fund corrective measures such as technology upgrades, staff training, rate adjustments, consumer arbitration, or consumer education; whenever a state agency must track, first as revenues and then as expenditures, financial transactions occurring wholly between ***non-governmental*** entities; and whenever, for example, the Commissioner signs a national class-action settlement which, through private financial transactions occurring wholly outside the state, benefits Montanans substantially but over which he had little or no negotiating role.

We believe the Legislative Auditor's recommendation places an impossible burden on agencies and adds meaningless numbers to the accounting system. For example, in addition to obtaining (and recording as revenue on the state's accounting system) a $210,000 payment as part of his Washington National settlement, the Commissioner also obtained the company's agreement to dedicate claims-handling staff and additional telephone capacity to answering Montana complaints. The Legislative Auditor's recommendation would require this office to estimate the dollar value of such transactions and then record it (when? on a cash basis? on an accrual basis?) as state revenue and state expenditures.

Recommendation #2:

We recommend the office ensure all securities on deposit are assigned to the office and security deposits are recorded on the state's accounting records in accordance with law.

Agency Response:

We do not concur. We disagree with the Legislative Auditor's conclusions but will comply with his recommendation. Montana law already requires the Commissioner to keep his own record of insurance company deposits, and we believe that the Legislative Auditor's recommendation imposes unnecessary, duplicative accounting duties that no other insurance regulator in the nation performs. Moreover, the Legislative Auditor recommends that this office "ensure **all** securities on deposit are assigned to the office," while Montana law only requires the Commissioner to obtain such assignments for **non-negotiable** securities.

Finally, the Legislative Auditor concludes on the basis of Montana law that the Commissioner holds **all** insurance company deposits (including cash and negotiable securities, neither of which need be assigned) in a fiduciary capacity and thus must record such deposits on the state's accounting records as "Property held in trust." None of the Montana statutes cited by the Legislative Auditor have changed since 1979, yet the Legislative Auditor has never previously criticized the Commissioner's method of accounting for insurance company deposits. In fact, the Legislative Auditor's December 1994 financial-compliance audit properly recommended (and this office implemented) changes regarding assignments of non-negotiable securities but never suggested, even by implication, that the Commissioner should be recording insurance company deposits on the state's accounting system as well as his own.

We believe that the Legislative Auditor's conclusion and recommendation mistakenly expose the State Auditor to new fiduciary liabilities for unassigned deposits actually entrusted under Montana law to qualified financial institutions contracting as trustees and charging insurance companies for custodial and administrative expenses.

Recommendation #3:

We recommend the office:

A. Record revenue and expenditures related to employee training travel on the state's accounting records in accordance with state policy.

B. Establish receivables for travel costs initially paid by the office and later reimbursed by a third party.

Agency Response:

We concur. We have written an internal policy memo to staff clarifying the procedure for NASAA and NAIC reimbursed travel. The office has established receivables for travel costs initially paid by the office that will be later reimbursed by a third party.

We wish to note that this office raised the issue of abating travel expenses with the Legislative Auditor's Office during our audit four years ago. At that time it was determined that abatement of travel expenses reimbursed by NASAA and NAIC was the proper procedure. We recognize that policies change and we have changed our procedures to comply.

Recommendation #4:

We recommend the office:

A. Seek legislation to allow deposit of securities examination revenue in the State Special Revenue Fund, or

B. Request General Fund budget authority to spend securities examination revenue.

Agency Response:

We concur. We will seek legislation to allow deposit of securities examination revenue in the State Special Revenue Fund.

Recommendation #5:

We recommend the office record financial information on the state's accounting records in accordance with state policy.

Agency Response:

We concur. We have had discussions with the Department of Administration, Accounting Division and the Office of Budget and Program Planning and have implemented a non-budgeted transfer to transfer Portfolio revenue to the General Fund. This transfer will be done on a regular basis.

We wish to note that this office discussed this issue with the Department of Administration, Accounting Division, prior to this audit. Because the State Auditor's office did not have transfer authority within its budget, a decision to continue residual equity transfers through the biennium was agreed upon. Due to the findings of the Legislative Auditor's audit, this issue was revisited and the non-budgeted procedure was recommended.

We have taken steps to correct the manner in which the premium tax liability is recorded.

Recommendation #6:

We recommend the office:

A. Adequately segregate revenue collection, receipt, and recording duties.

B. Ensure revenue recorded on the state's accounting records is allocated to proper revenue classifications.

Agency Response:

We concur. Job duties have been reassigned to adequately segregate revenue collection, receipt and recording duties.

Revenue is balanced to SBAS on a monthly basis. All revenue has been accounted for

and deposited. We believe that revenue has been properly allocated to revenue classifications. The office will implement in FY99 a new internal computer system that will be able to reconcile to SBAS.

I would like to thank your staff for their time and effort during this audit. They were very helpful addressing issues that concerned my staff and pointing out areas that need improvement.

Sincerely,

Mark O'Keefe
State Auditor

MOK/jhn